

Message Text

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ORIGIN FRB-03

INFO OCT-01 EUR-12 ISO-00 H-02 EB-07 /025 R

DRAFTED BY: FED RES-NBERNARD

APPROVED BY: EUR/NE-JJCROWLEY

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P 122258Z MAY 76

FM SECSTATE WASHDC

TO AMEMBASSY LONDON PRIORITY

C O N F I D E N T I A L STATE 116936

FOR: THE HONORABLE ARTHUR F. BURNS, CHAIRMAN,
FEDERAL RESERVE BOARD, C/O AMBASSADOR
ARMSTRONG

GUENTHER REPORTS THAT MR. LILLY HAS COMPLETED CONSULTATIONS ON HILL. HIS VISITS WITH SENATORS GARN, MCINTYRE, AND MORGAN WENT EXCEEDINGLY WELL. RULES COMMITTEE CONSIDERATION OF GOVERNMENT IN THE SUNSHINE HAS BEEN POSTPONED. BILL IS NOW LIKELY TO BE BEFORE RULES NEXT WEDNESDAY AND GOVERNMENT OPERATIONS LEADERSHIP ANTICIPATES HOUSE FLOOR ACTION ON THURSDAY. CARLSON ADVISES FURTHER THAT CONGRESSMAN HORTON WILL OFFER VERBATIM TRANSCRIPT AMENDMENT ON HOUSE FLOOR, ASSUMING THAT THE RULE GRANTED WILL SO PERMIT. CARLSON ASKS OUR SUPPORT. GUENTHER REQUESTS YOUR ADVICE REGARDING BALLES. MCINTYRE DID NOT HAVE SUBSTANTIVE COMMENT OR REQUEST ON INSIDER LOAN LETTER BUT NOTED THAT HIS STAFF WOULD TRY TO WORK SOMETHING OUR WITH MCLEAN PRIOR TO FLOOR CONSIDERATION OF BILL.

GAO TODAY FURNISHED US WITH A COPY OF A LETTER FROM CHAIRMEN REUSS AND ST GERMAIN TO MR. STAATS THAT REFUSES TO ACCEPT THE NARROW SCOPE OF THE GAO STUDY PROVIDED IN OUR AGREEMENT WITH GAO. THE REUSS-ST GERMAIN LETTER INSISTS THAT THE AUDIT "FULLY COVER THE FEDERAL RESERVE'S RESPONSIBILITIES RELATING TO ALL ASPECTS OF THE BANK HOLDING COMPANIES," INCLUDING NON-BANK SUBSIDIARIES. IT REPEATEDLY CHARACTERIZES THE STUDY AS AN "AUDIT," AND EMPHASIZES THAT THE COMMITTEE'S REQUEST "IS FOR A FULL AUDIT OF ALL BANK SUPERVISORY AND REGULATORY FUNCTIONS." WE HAVE HAD
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AN UNDERSTANDING WITH GAO THAT THE AGREEMENT WOULD NOT BECOME

EFFECTIVE UNTIL APPROVED BY THE COMMITTEE. ACCORDINGLY, HAWKE HAS ADVISED GAO STAFF THAT IT IS HIS VIEW THAT THE AGREEMENT HAS NOT YET BECOME EFFECTIVE BECAUSE THE REUSS-ST GERMAIN LETTER DOES NOT CONSTITUTE SUCH APPROVAL. HAWKE INTENDS TO REPORT ON THE STATUS OF THE MATTER AT THE BOARD MEETING ON FRIDAY. THE PRICE OF HEAVY FUEL OIL HAS BEEN REDUCED FOR MAY FROM 30 CENTS TO 83 CENTS A BARREL, NET, BY THREE LEADING SELLERS. THE REDUCTIONS LARGELY REFLECT CONTINUED SOFTNESS IN HEAVY-FUEL MARKETS AND RECENT CHANGES IN THE FEA'S PROGRAM. PRICES OF BASIC COMMODITIES, NOT SEASONALLY ADJUSTED, ROSE 1.1 PERCENT IN THE WEEK ENDED MAY 11, AFTER TWO WEEKS OF DECLINE. PRICES OF INDUSTRIAL MATERIALS WERE UNCHANGED IN THE RECENT SEVEN-DAY PERIOD AFTER DECLINING IN THE PRECEDING WEEK. PRICES OF FOODSTUFFS ROSE 2.4 PERCENT OVER THE PAST WEEK, WITH INCREASES WIDESPREAD. THE DOLLAR FIRMED AGAINST ALL MAJOR CURRENCIES OTHER THAN STERLING TODAY, RISING ABOUT 0.2 PERCENT ON A TRADE-WEIGHTED BASIS. THE DOLLAR'S RISE TODAY WAS ATTRIBUTED PRIMARILY TO INCREASES IN U.S. MONEY MARKET RATES. THE ITALIAN LIRA WAS OFF ABOUT 0.8 PERCENT AND THE BANK OF ITALY SOLD A MODERATE AMOUNT OF DOLLARS. THE SWISS FRANC FELL ABOUT 0.6 PERCENT WITH THE AID OF A SMALL PURCHASE OF DOLLARS BY THE SWISS NATIONAL BANK. OTHER CONTINENTAL CURRENCIES DECLINED BY 0.2 PERCENT OR LESS AGAINST THE DOLLAR. STERLING FIRMED SLIGHTLY FROM YESTERDAY. THE BANK OF ENGLAND HELPED MAINTAIN THE RATE WITH THE SALE OF A MODERATE AMOUNT OF DOLLARS. THE SYSTEM PURCHASED SMALL AMOUNTS OF BELGIAN FRANCS AND GERMAN MARKS. LONDON GOLD WAS DOL127.90 AT THE SECOND FIXING, UP 5 CENTS FROM YESTERDAY. FINANCE MINISTER OHIRA ANNOUNCED IN PARLIAMENT TODAY THAT JAPAN HAS SOLD ABOUT DOL300 MILLION WORTH OF LONG-TERM GOVERNMENT BONDS TO FOREIGN COUNTRIES WHICH WANTED TO DIVERSIFY THEIR RESERVE ASSETS. HE EXPLAINED THAT THE SALES WERE MADE THROUGH THE BANK OF JAPAN TO THE CENTRAL BANKS OF THE COUNTRIES AT CURRENT MARKET PRICES.

THE TREASURY BILL MARKET CONTINUED TO EXHIBIT A WEAK TONE TODAY AS MARKET ATTENTION REMAINED FOCUSED ON THE FEDERAL FUNDS RATE. THE 3-MONTH BILL ROSE 8 BASIS POINTS FURTHER TO 5.14 PERCENT. FEDERAL FUNDS TRADED IN A RANGE OF 5-1/16 TO 5-1/2 PERCENT, WITH AN EFFECTIVE RATE OF 5.20 PERCENT ANTICIPATED. THE DESK MADE DOL1.4 BILLION OF OVERNIGHT REPURCHASES AGREEMENTS THIS AFTERNOON AND THE RATE FELL BACK TOWARD 5 PERCENT LATE IN THE DAY. CONFIDENTIAL

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STOCK PRICES FLUCTUATED NARROWLY IN MODERATE TRADING. THE DOW JONES INDUSTRIALS CLOSED 1 POINT LOWER AT ABOUT 1006. M-1 APPEARS TO BE LITTLE CHANGED FROM EARLIER ESTIMATES FOR THE WEEK ENDING MAY 5, BUT PRELIMINARY DATA SUGGESTS SOME STRENGTHENING FOR THE WEEK ENDING MAY 12. KISSINGER

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FUEL OIL, LEGISLATIVE BILLS, GAO AUDITS, PRICES, FOREIGN EXCHANGE RATES, GOLD TRANSACTIONS, BANKS
Control Number: n/a
Copy: SINGLE
Draft Date: 12 MAY 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: SmithRJ
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976STATE116936
Document Source: CORE
Document Unique ID: 00
Drafter: NBERNARD
Enclosure: DC ADUSTED PER NORMAN/CHICHESTER TELCON
Executive Order: RR
Errors: N/A
Film Number: D760183-0996
From: SECSTATE WASHDC
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19760561/aaaacahx.tel
Line Count: 112
Locator: TEXT ON-LINE, ON MICROFILM
Office: ORIGIN FRB
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: SmithRJ
Review Comment: n/a
Review Content Flags:
Review Date: 17 MAY 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <17 MAY 2004 by BoyleJA>; APPROVED <09 SEP 2004 by SmithRJ>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: IDIARIES. IT REPEATEDLY CHARACTERIZES THE STUDY AS AN "AUDIT," AND EMPHASIZES THAT THE COMMITTEE'S REQUEST "IS FOR A FULL AUDIT
TAGS: EFIN, ENRG, AAUD, US, JA, XG, UK, FRB
To: LONDON
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006